NO. 90-379

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1990

PAUL AND MELINA FISHER,

Petitioner's

versus

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTIONS PRESENTED

The Commissioner of Internal Revenue used the net worth method in reconstructing the taxpayers income. The Fifth Circuit held the government had carried its burden of proof evidencing there were net worth increases of $42,000 and $8,000. The question presented is:

> Did the Fifth Circuit err in expressly holding there was no requirement for the government to prove a consistent pattern of underreporting substantial amounts of income, which holding is in direct conflict with the decision of this Court in *Holand v. United States* ?

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1990

PAUL AND MELINA FISHER,
Petitioner's

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners Paul and Melinda Fisher, respectfully pray a Writ of Certiorari issue to review the Judgment of the Fifth Circuit Court of Appeals entered in this proceeding on May 22, 1990 and the denial of a Petition for Rehearing on June 14, 1990.

CITATIONS TO OPINIONS BELOW

The United States Tax Court, Judge Shields, entered its opinion reported in Tax Court Memo 1988-151. The Fifth Circuit Court of Appeals, Judges Brown, Williams and Jones entered its opinion in an unpublished opinion.

JURISDICTION

Petitioners appeal from the judgment of the Fifth Circuit Court of Appeals decided May 22, 1990. Petitioner's petition for rehearing was denied June 14, 1990.

Jurisdiction of this Court is invoked under 28 U.S.C. 1254 and 2101 and Supreme Court Rule 10.

STATEMENT OF THE CASE

Petitioners filed timely income tax returns for 1976 and 1977. Subsequent to the running of the three year statute of limitations the Commissioner determined petitioners had underreported their income and were also liable for the civil fraud penalty. The existence of fraud lifts the statute of limitations.

The Commissioner used the net worth method to reconstruct petitioners income. There was no specific transaction reflecting unreported income. Citing *Holland v. United States,* the Tax Court approved the method as applied. On appeal, the Fifth Circuit held that the government had carried its burden of proof by clear and convincing evidence that there were increases in net worth of $42,310.70 for 1976 and $7,860.01 in 1977 thereby shifting to petitioners the burden of disproving the total alleged understatements of income of $113,710.70 in 1976 and $104,760.01 in 1977.

The Fifth Circuit stated in footnote 9 of its opinion:

> "9. The Fishers argue in their brief that in order to prove fraud the Commissioner must prove a "consistent pattern of underreporting substantial amounts of income." There is no such requirement. Rather, a consistent pattern of underreporting substantial amounts of income is merely one of the indicia of fraud on which the Commissioner may rely. *See Patton v. Commissioner,* 799 F.2d 166, 171 (5th Cir. 1986)."

In their petition for rehearing it was petitioners position that $7860.01 was not a substantial omission so to

eliminate 1977. Further, there would be no "consistent pattern" of increases in net worth where there is only one year 1976 left.

REASONS WHY THE WRIT SHOULD BE GRANTED

The use of the net worth method to prove unreported income has long been common in income tax cases. The standards of review have heretofore been uniform based in this Court's landmark decision in *Holland v. United States* (1954) 348 U.S. 121. In the instant case the Fifth Circuit expressly rejected the standards requiring the unreported income be substantial and consistently omitted.

In tax cases involving fraud the burden rests on the government of proving substantial deficiencies in taxes exist which were due to a fraudulent intent. *United States v. Spier* (Sup. Ct. 1943) 317 U.S. 492. The same requirements exist for civil fraud. *Plunkett v. Commissioner* (7th Circuit 1972) 465 F.2d 299, 303; *Fairchild v. United States,* 240 F.2d 944, 948 (5th Cir. 1957); *Kahr v. Commissioner,* 414 F.2d 621, 627 (2nd Cir. 1969); *Amos v. Commissioner,* 43 T.C. 50, 55 (1964), *aff'd,* 360 F.2d 358 (4th Cir. 1965).

The requirement that there be a substantial tax deficiency is originally an offshoot of the element of willfulness, for it has been frequency stated that only by a showing of a substantial deficiency can the government meet its burden of negating the possibility than an underpayment of taxes was due to oversight or carelessness. *United States v. Gross,* 276 F.2d 816 (2nd Cir. 1960), *cert. denied,* 363 U.S. 831 (1960), *aff'd per curiam* 286 F.2d 59 (2d Cir. 1961); *U.S. v. Parr,* 509 F.2d 1381 (5th Cir. 1975). Accord Department of Justice, "Criminal Tax Manual" Section 8.05(3).

The rule of substantiality is also of great significance where the government proceeds accordingly to the net worth in the tax year. The courts have held that reliance on such circumstantial evidence is justified only if there is proof of a substantial underpayment of taxes. The following circuits have so held in net worth income tax cases involving fraud:

U.S. v. Burdick, 221 F.2d 932 (3rd Cir. 1955), *cert. denied* 350 U.S. 831 (1955); *U.S. v. Eley,* 314 F.2d 127 (7th Cir. 1963); *Watts v. U.S.,* 212 F.2d 275 (10th Cir. 1954); *U.S. v. Skalicky,* 615 F.2d 1117 (5th Cir. 1980); *Schwarzkopf v. Commissioner,* 246 F.2d 731 (3rd Cir. 1957); *Gatling v. Commissioner,* 286 F.2d 139 (4th Cir. 1961); *Epstein v. U.S.,* 246 F.2d 563 (6th Cir. 1957); *Shaw v. Commissioner,* 252 F.2d 681 (6th Cir. 1958); *U. S. v. Larson,* 612 F.2d 1301 (8th Cir. 1980) *cert. denied,* 446 U.S. 936 (1980).

In *Holland v. United States,* (1954) 348 U.S. 121 this Court set out the legal standards applicable to use of the net worth method to prove unreported income, holding that requisite willfulness could be inferred where there is "evidence of a consistent pattern of underreporting large amounts of income".

In the instant case the Fifth Circuit expressly rejected the standard of substantiality and successive years of *Holland,* stating:

> "9. The Fishers argue in their brief that in order to prove fraud the Commissioner must prove a "consistent pattern of underreporting substantial amounts of income". There is no such requirement. Rather, a consistent pattern of underreporting substantial amounts of income is merely one of the indicia of fraud on which the

Commissioner may rely. See *Patton v. Commissioner,* 799 F.2d 166, 171 (5th Cir. 1986)."

However, *Patton* was not a net worth case, rather specific kickbacks were proved. The Court actually held that "Patton consistently failed to report substantial amounts of income over a period of years".

The principle running throughout the net worth fraud cases has been the requirement that the Commissioner must prove there has been a consistent pattern of not reporting substantial income, with some courts requiring additional indicia of fraud, but all requiring the basic two elements of consistency and substantiality.

The significance of the difference between the legal standards is not conceptual, rather it is jugular. The Fifth Circuit held that the Commissioner had proved by clear and convincing evidence that the appellants had unreported income of $42,310.70 in 1976 and $7,860.01 for 1977, thereby making a prima facie fraud case. Unreported income of $7,860.01 and the tax thereon is obviously de minimums, not substantial, particularly in a case where the Commissioner is claiming understatements of income of $97,139.00 in 1977 with tax thereon of $43,453.00 plus a civil fraud penalty of $21,727.00 Even the Tax Court has held that $5,000 a year over a 3 year period in a net worth case would not constitute a consistent understatement of substantial income so to support the civil fraud penalty *Estate of Nicholas Hanna* (1976) T.C. Memo 76,032.

Had the correct legal standard requiring a consistent pattern of not reporting substantial income been applied the year 1977 would have been eliminated, leaving only 1976. Obviously there can be no "consistent pattern" in a net worth case when only one year is involved.

In view of the conflict of the decision below with past decisions of this Court, the Court may wish to consider summary reversal.

CONCLUSION AND PRAYER

Because of the importance and broad application of these issues in Federal tax cases, the petitioners pray that this Court grant a Petition of Certiorari to the United States Supreme Court.

Respectfully submitted

_____

TOWNER SHIELDS LEEPER

PROOF OF SERVICE

The undersigned attorney of record for Petitioners, Paul and Melinda Fisher, here certifies as follows:

(A) That I, Towner Shields Leeper, a member of the bar of the United States Supreme Court, and that I have duly served all parties required by the rules of said Court to be served with the foregoing Petition for Writ of Certiorari, as hereinafter Shown:

(B) That the names and addresses of the attorneys of record for the adverse party are as follows:

The Honorable Kenneth W. Starr
Solicitor General of the United States
Department of Justice
Washington, D.C. 20530

The honorable Shirley D. Peterson
Assistant Attorney General
Department of Justice
Washington, D.C. 20530

(C) That on this day, I served three printed copies of the foregoing Petition for Certiorari on the said Kenneth Starr and the said Shirley D. Peterson, Attorneys for said Respondent, by depositing same in the United States Mail First Class property addressed to said Attorneys for Respondent at their said address.

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APPENDIX A

T. C. Memo. 1988-151

UNITED STATES TAX COURT

PAUL FISHER AND MELINDA FISHER, Petitioners
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 3908-85. Filed April 12, 1988.

Towner Leeper, for the petitioners.
Byron Calderon, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

SHIELDS, *Judge:* Respondent determined deficiencies in and additions to petitioners' income taxes as follows:

Year	Deficiency	Addition to Tax Section 6653 (b)[1]
1976	$27,822	$13,911
1977	$43,453	$21,727

The issues for decision are: (1) whether additions to tax for fraud as provided by section 6653(b) are due from Paul Fisher[2] for the years 1976 and 1977; (2) whether the

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[1] All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated. All rule references are to the Tax Court Rules of Practice and Procedure unless otherwise provided.

[2] The addition to tax under section 6653(b) was not determined against Melinda Fisher in the statutory notice.

assessment of any deficiency due from the petitioners for 1976 or 1977 is barred by the statute of limitations; and (3) the amounts, if any, by which the adjusted gross incomes of petitioners for the years 1976 and 1977 are understated.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulations of facts and the exhibits associated therewith are incorporated herein by reference.

Petitioners, Paul and Melinda[3] Fisher, husband and wife, reside in El Paso, Texas, during 1976 and 1977 and at the time of filing their petition. Their joint income tax returns for 1976 and 1977 were timely filed on or before April 15, 1977 and April 15, 1978, respecttively, with the Internal Revenue Service Center in Austin. The returns reflected adjusted gross incomes of $12,261 in 1976 and $11,925 in 1977.

Paul Fisher graduated in 1957 from the University of Texas with a degree in business administration. While earning his degree, he completed a number of courses in accounting, business law and finance.

During 1970 or 1971, Paul Fisher entered into an oral partnership agreement with Albert McCardle. The partnership, know as McCardle and Fisher, continued through 1977. Under the oral agreement the only partners in the partnership were Paul Fisher and Alber McCardle; McCardle's contribution to the partnership was labor and services; Fisher's contribution to the partnership was money;

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[3] Melinda Fisher is a party to this action solely by virtue of having signed a joint return with Paul Fisher. All further references to petitioner in the singular are to Paul Fisher.

and McCradle conducted the day-to-day operations of the partnership and was responsible for its banking transactions.

On April 10, 1972, Paul Fisher purchased from his father (J.L. Fisher) a one-half interest in a store building in Lampasas for $21,000. In 1976, Paul Fisher's liability for part of the purchase price was reduced by payments made by petitioner to his father totalling $7,479. In 1977, the liability was further reduced by similar payments totalling $3,150.

On June 19, 1974, petitioner borrowed $30,000 from the First National Bank of Lampasas which he invested in a real estate limited partnership known as Crystal Park. This $30,000 was petitioner's total investment in the partnership and on the 1974 and 1975 joint returns, petitioner deducted losses from Crystal Park of $3,454.12 and $26,538.00, respectfully. Petitioner's returns for 1976 and 1977 reflect no income or loss from the partnership but Paul Fisher made payments on the loan from the First National Bank of $4,000 in 1976 and $20,895.23 in 1977.

During 1976 and 1977 and for several years prior thereto, Paul Fisher was an inveterate gambler. His gambling activities included substantial wages on games of golf, poker, gin rummy, and football, as well as at the casinos in Las Vegas, Reno and other gambling resorts. He was also an accomplished golfer with a zero handicap and had been the proud winner in 1973 of the amateur section of the National Open of Mexico with his longtime friend and professional partner Lee Trevino.

Paul Fisher was a member of several local clubs including El Paso Country Club, Coronado Country Club and Vista Hills Country Club. He joined these clubs after con-

cluding that he could make more money playing golf and poker at the clubs than his total costs of belonging.

Nearly every day during the years at issue, Fisher played one or more golf matches on which wages were made at one of the country clubs. Subsequent to the golf matches, he usually played poker or gin rummy at one of the clubs or at a private residence. Almost all wages were paid in cash and no record was made of his winnings or loses.

During the same period, Fisher also bet on football games by placing wages by telephone with B.J. Chapman, also known as Bobby Chapman or Bobby Joe Chapman, a bookmaker in Dallas. Petitioner was not a bookmaker but he occasionally placed bets at no gain or loss in his name with Chapman for a friend or friends.

Chapman did not attempt to settle up[4] with Fisher after each bet or at the end of each day or even at the end of each week of wagering. Instead, Chapman maintained a temporary record of their dealings and, when either of them wanted to settle up, payment would be promptly made by the net loser, usually by mailing a cashier's check or checks to the other.

The cashier's checks obtained by Fisher and sent to Chapman were not made payable to Chapman because Chapman's activities were illegal in Dallas and he did not want a record made of the payments to him. Instead, petitioner's cashier's checks were made out to fictitious payees. Chapman never deposited and seldom cashed one of the checks. When he had to cash one he just endorsed it for the fictitious payee and passed it on to some other party to

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[4] Referred to at times by both Chapman and Fisher as "straightening up."

deposit or cash. Most of the cashier's checks were used by Fisher and Chapman as cash because Chapman would simply hold the checks made payable to fictitious payees by Fisher until such time as Chapman had a balance due Fisher. At that time, the checks were returned to Fisher in settlement of the balance due.

Fisher kept no record of the football wages he made with Chapman. From one settlement date to the next Chapman kept a running account of the amount owed by or to Fisher but these records were destroyed when payment was made because Chapman did not want any incriminating records available to the local authorities. The record contains no evidence that petitioner ever objected to the use of the cashier's checks being made payable to fictitious parties or to their use as a substitute for cash. In fact, at trial Chapman was under the impression that these arrangements were equally satisfactory to Fisher, and one of petitioner's former representatives, Gonzalo Diaz, told respondent's agent that Fisher had told him that the use of such cashier's checks was frequently employed by "dopers and gamblers" in order to avoid the tracing of the funds represented by the checks. The record contains no evidence of any denial of this statement by petitioner. It does contain a statement by respondent's agent that his investigation failed to reveal any evidence that Fisher was a "doper."

Petitioners' income tax returns for 1976 and 1977 were prepared by Raymond M. Larkin, a certified public accountant in El Paso with 31 years of experience. Mr Larkin also prepared the 1976 and 1977 information returns for the McCardle and Fisher partnership.

For use in the preparation of petitioners' 1976 income tax return, Fisher provided Mr. Larkin with the

books and records of the partnership and information regarding the rental of the store building in Lampasas. Fisher did not provide Mr. Larkin with any record of his gambling activities in 1976 or advise Mr. Larkin that any gambling transactions had occurred during the year. The 1976 income tax return reflected all income and expenses with respect to which information was given to Mr. Larkin.

In the course of preparing the 1977 return for the McCardle and Fisher partnership, Mr. Larkin had a discussion with Fisher concerning a cash transaction that occurred in 1978. The discussion prompted Mr. Larkin to ask whether petitioner had any gambling income in 1977. In reply, Fisher advised Mr. Larkin that he had received $15,000 in gambling income in 1977 but did not produce any record of his gambling transactions. The gambling income of $15,000 was reported on the 1977 return as "miscellaneous income."

On November 16, 1977, Paul Fisher gave $27,700 in currency to University Bank in El Paso and caused $5,000 of the currency to be deposited in his personal checking account and the balance of $22,700 to be used to purchase three cashier's checks (numbers 15703, 15704 and 15705). University Bank prepared and filed with the Internal Revenue Service a Currency Transaction Report, Form 4789, regarding the transaction. The report was received by the Internal Revenue Service no later than February 10, 1978.

Philip Rocha, one of respondent's agents, began an examination of petitioners' 1976 and 1977 income tax returns with an interview of Paul Fisher on October 18, 1978. At that time, Mr. Rocha was aware of the November 16, 1977 currency transaction between petitioner and the

University Bank. Fisher appeared at the interview without counsel and without any books or records.

At the initial interview, Fisher stated that the $15,000 of miscellaneous income reported on the 1977 income tax return was from gambling, that the $15,000 was all the gambling income he received in 1977, and that he had no books or records reflecting his gambling activities. Fisher also told Mr. Rocha that during 1976 he had more gambling losses than winnings.

During the initial interview, petitioner also stated to the agent that in 1976 and 1977 he realized no income other than the amounts shown on the returns, that he had no expenses or deductions which were not reported on the returns, that the returns were correct as filed, that he had not received or made any loans during 1976 and 1977, and that the mortgage on his home represented the only loan he had outstanding during those years.

When questioned by the agent about the currency transaction in November 1977, Fisher said that he could not recall the transaction and did not remember purchasing any cashier's checks at that date. Petitioner stated that he remembered purchasing cashier's check for $3,000 in or about November of 1976 and that his normal practice during the years at issue was to deposit all of his income into his bank accounts and to pay almost all of his expenses with checks but occasionally with currency.

Agent Rocha interviewed Paul Fisher again on November 20, 1978. During that interview, Paul Fisher stated that his normal practice was to deposit al of his gambling winnings into his checking account although he usually kept about $300 of currency in his wallet.

A third interview of Paul Fisher by Mr. Rocha was held on December 1, 1978. At this interview, Mr. Rocha advised petitioner that an analysis of petitioner's bank deposits had disclosed a possible understatement of income for 1976 and 1977.

Still a fourth interview was had by Rocha with Paul Fisher on December 8, 1978. At this interview, petitioner stated that he still could not recall the currency transaction that occurred in November 1977, but that if such transaction had taken place, the currency involved was either proceeds of a loan or a cash withdrawal from the McCardle and Fisher partnership. When asked again about the apparent discrepancy between bank deposits and income reported on his 1976 and 1977 income tax returns, Paul Fisher's explanations were that the discrepancy could possibly be due to currency loans from his father, partnership withdrawals, or additional gambling income. Specifically, Paul Fisher stated that in 1977 he had a $7,000 currency loan form his father and a $26,000 currency withdrawal from the McCardle and Fisher partnership.

On December 18, 1978, Paul Fisher was interviewed for the fifth time by Mr. Rocha. At this meeting, Paul Fisher produced hs own version of an analysis of his bank deposits for 1977 which contained the following detail:

DEPOSITS	SOURCE
$24,900.00	Withdrawals from checking accounts
$26,859.00	Cash withdrawal from partnership
$15,000.00	Reported gambling income
$ 9,478.71	Cash-on-hand depletion
$76,237.71	

Paul Fisher told Mr. Rocha at this interview that if an item was income he would *not* have deposited it into his bank account.

On February 5, 1979, in substantiation of the alleged loans from his father, Paul Fisher gave Rocha a letter postmarked December 21, 1978, from J. L. Fisher to petitioner. The letter stated "Oh yeah, I still have you on my books for the $12,000 in '76 and $7,000 in '77. You know it may be a cold winter."

Agent Rocha had no further contacts with petitioner because the audit of the joint returns for 1976 and 1977 was completed by revenue agent Rick Schampers. Mr. Schampers also audited the partnership returns of McCardle and Fisher for 1976 and 1977. During the completion of the audit Mr. Schampers reconstructed petitioners' adjusted gross imcome for 1976 and 1977 by an analysis of their net worth increases during such years plus nondeductible expenditures. From this analysis, revenue agent Schampers concluded that for the taxible years 1976 and 1977 petitioners had understated their adjusted gross income by a total of $113,791.65 for 1976 and $104,703.01 for 1977 and their net incomes by $100,613.15 and $107,928.01, respectfully. The agent's computation of the omissions from income with adjustments for those items which were attributable to the McCardle and Fisher partnership is as follows:

A-10

NET WORTH COMPUTATION

ASSETS:	12-31-75	12-31-76	12-31-77
Cash on hand	$ 1,000.00	$ 4,000.00	$ 10,000.00
Cash in banks	(1,416.58)	4,086.64	10,260.47
Receivables	11,200.00	20,550.00	23,150.00
Prepaid interest	532.77	326.49	-0-
Automobiles	---	---	7,415.80
Escrow-accounts on residence	323.00	122.25	-0-
Real Estate			
A. Residence	32,000.00	32,000.00	40,916.00
B. Store bldg. Lampasas,Tx.	43,533.00	43,533.00	43,533.00
Capital Account McCardle and Fisher Partnership	49,290.00	96,948.00	74,474.00
Total Assets	$136,462.19	$201,566.38	$209,749.27
LIABILITIES			
Bank Loans	$ 53,009.53	$ 48,907.08	$ 14,870.36
Casino loans	5,500.00	10,000.00	10,000,00
J.L. Fisher	22,000.00	14,521.00	11,371.00
Martin Bauman	7,750.00	4,750.00	1,750.00
Reserve for Depreciation	1,658.00	3,289.00	4,920.00
Total Liabilities	$ 89,917.53	$ 81,467.08	$ 42,911.36

NET WORTH COMPUTATION (continued)

	12-31-75	12-31-76	12-31-77
TOTAL ASSETS	$136,462.19	$201,566.38	$209,749.27
Less total liab.	89,917.53	81,467.08	42,911.36
Net worth	$ 46,544.66	$120,099.30	$166,837.91
Less net worth beginning of year		$ 46,544.66	$120,099.30
Increase to net worth		$ 73,554.64	$ 46,738.61
PLUS:			
Personal living expenses		19,408.98	21,439.40
Other nondeductible expenditures		35,700.00	48,450.00
TOTAL		$128,663.62	$116,628.01
Less nontaxible sources:			
Payments from Gilbert Felts		(550.00)	
Insurance proceeds		(592.97)	
Capital gaines deduction (section 1202)		(1,468.00)	
Adjusted Gross Income, corrected		$126,052.65	$116,628.01
Adjusted Gross income, reported		12,261.00	11,925.00
Total Adjusted Gross Incomne omitted		$113,791.65	$104,703.01
Other adjustments:			
Adjustments attributable to partnership:			
Ordinary income-plus (minus)		(12,844.00)	5,346.00
Captial Gains		(669.00)	---
Capital Gains deduction on above		334.50	
Basis correction in park			(2,121.00)
Actual Understatement of Adjusted Gross Income		$100,613.15	$107,928.01

During the audit by revenue agent Schampers, a criminal investigation with respect to Paul Fisher for the taxable years 1976 and 1977 was conducted by special agent Edward Wagner. In an attempt to verify the loans made to Paul Fisher by his father, J.L. Fisher, Mr. Wagner

attempted to interview both of petitioner's parents and when they failed to produce any evidence tending to corroborate the loans, he performed a detailed analysis of their various bank records. In all, Mr. Wagner found that approximately $661 in checks were drawn on J.L. Fisher's accounts during 1976 and 1977 that were payable to Paul Fisher or to cash. His analysis of Mrs. J. L. Fisher's accounts for the years 1976 and 1977 revealed slightly less than $600 in checks that were payable during 1976 and 1977 to Paul Fisher, members of his family, or cash.

In respondent's net worth computation the liability at December 31, 1975 which is referred to as Casino loans in the total amount of $5,500.00 included $5,00.00 which Paul Fisher owed at that time to Ceasar's Palace in Las Vegas. In May of 1976, this debt by Paul Fisher to Ceasar's Palace was cancelled on the records of Ceasar's Palace with a notation that the debt had been transferred from the account of Paul Fisher to the account of Lee Chagra. This transaction represented the satisfaction by Chegra to Paul Fisher of a gambling debt and in the net worth computation, Casino loans at the end of 1976, did not include this $5,000.00.

Respondent's net worth computation contains an asset entitled receivables which includes the balance owed by Albert McCardle at the end of each of the years 1975, 1976, and 1977 to Paul Fisher. The total amount of such receivables at the end of each of the years 1975, 1976, and 1977 was $11,200.00, $18,450.00, and $21,050.00, respectfully.

During each of the years 1975, 1976 and 1977, Paul Fisher purchased cashier's checks from University bank. The cashier's checks which are in controversy in this case include one purchased in 1975, six purchased in 1976, and

nine purchased in 1977. The numbers, dates, amounts, remitters, and payees reflected on these 16 checks are set out in the following schedule:

Check Number	Date	Amount	Remitter	Payee
		1975		
8094	12-24-75	$ 7,500	Robert Miller	Robert Miller
		1976		
8734	03-05-76	$ 3,000	McCardle & Fisher	Gene McCardle & Gene Fisher
10429	08-24-76	$ 6,100	Jack Miller	Jack Miller
10508	09-01-76	$12,500	McCardle & Fisher	Gene McCardle & Gene Fisher
10509	09-01-76	$ 2,100	Jack McCafferty	Jack McCafferty
11162	10-20-76	$ 3,000	Jack McCafferty	Robert Miller
11690	12-30-76	$ 9,000	McCardle or Fisher	Gene McCardle & Gene Fisher
		$35,700		
		1977		
*14908	09-09-77	$ 7,550	Wayne Steinart	Wayne Steinart
15411	10-20-77	$ 7,800	Gene Fisher	Jack Straus
15436	10-25-77	$ 2,100	Gene Fisher	Jack Blakely
*15703	11-16-77	$ 7,000	Gene Fisher	Leroy Poole
15704	11-16-77	$ 7,000	Gene Fisher	Robert Knapp
*15705	11-16-77	$ 8,700	Gene Fisher	Larry Kiel
15753	11-22-77	$ 1,700	Gene Fisher	Jack Martin
*15923	12-07-77	$ 3,600	Gene Fisher	Charles Davis
15922	12-07-77	$ 3,000	Gene Fisher	Charles Davis
		$48,450		

The reverse side of each of the above checks bears an endorsement by the payee or payees shown on the front thereof. The reverse side of check number 8094 also bears

the initials "B. J. C." and was cashed in Dallas on January, 14, 1976, by Bobby Chapman. All of the 1976 checks totaling $35,700 were cashed at the Merchant State Bank in Dallas. Of the 1977 checks a total of $26,850 (those bearing an asterisk) were cashed at the same place. The record fails to disclose who cashed these checks.

With respect to the five checks in 1977 which were not cashed in Dallas, Paul Fisher advised respondent's agent as follows:

> I understand you are auditing my income taxes for 1976 and 1977 and have asked that I identify certain cashier's checks drawn on the University Bank of El Paso by me. After reviewing copies of the cashier's checks and endorsements thereon I am able to identify the following:
>
> * * *
>
> *Cashiers check [#]15411* for $7,800.00 - payable to Jack Straus was cashed at the Valley Bank of Nevada, Las Vegas, Nevada to pay my gambling losses.
>
> *Cashiers check #15436* for $2,100.00 - payable to Jack Blakely was deposited to the Miller Gordon Motor Company in Dallas and this represented a payment of gambling debts by me.
>
> *Cashiers check #15704* for $7,000.00 - payable to Robert Knapp was cashed at the Union Plaza, Las Vegas, Nevada. The Union Plaza is a casino in Las Vegas and the money was used to pay my gambling losses.
>
> *Cashiers check #15753* for $1,700.00 - payable to Jack Martin was cashed at the Valley Bank of Nevada, Las Vegas, Nevada, to pay my gambling debts.
>
> *Cashiers check #15922* for $3,000.00 - payable to Charles Davis was cashed at the Bank of Nevada, Las Vegas, Nevada, to pay my gambling debts.

At trial Fisher testified to the same effect, but failed to explain how he was able to cash or otherwise apply the checks to his debts when they were made payable to Jack Straus, Jack Blakely, Robert Knapp, Jack Martin and Charles Davis. He also failed to identify these parties or to assert whether the names were real or fictitious.

During 1975, 1976 and 1977, Kelly Fisher, one of petitioner's dependent children was a full-time unemployed student. On July 16, 1975, she borrowed $3,431.64 from Franklin National Bank of El Paso to purchase a 1975 Toyota. Paul Fisher co-signed the note with his daughter and made the payments on the loan to the bank during 1976 and 1977. The outstanding balance on the liability to the bank at December 31, 1975, 1976 and 1977 was reflected in respondent's net worth computation.

Paul Fisher had an 85-percent interest in the McCardle and Fisher partnership during 1976. During 1977, he held a 50-percent interest in the partnership.

During 1976 the partnership was engaged in several ventures. Its primary business was the sale of lots in Paso View Development. In 1976, the partnership also owned and operated a mobile home park known as Red Arrow Desert Oasis Park for which it had a separate bank account. In addition, the partnership operated a store known as Red Arrow Desert Oasis Store which also had a separate bank account.

Revenue agent Schampers performed a thorough audit of the books and records of the McCardle and Fisher partnership. The audit included an examination of every liability ledger for each lot sold in the Paso View Development and an upward or downward adjustment for all the interest.

Paul Fisher's capital account in the partnership as of December 31, 1975, as reflected on its 1975 return was $49,290. During 1976 and 1977, petitioner made capital contributions to the partnership of $26,350 and $3,100 respectfully. During 1976, petitioner made a cash withdrawal of $3,000. After adjustments revealed by the audit of the partnership records, petitioner's share of oridnary income and capital gains for 1976 was $21,372 and $2,936 respectively. After adjustments revealed by the audit of the partnership records, petitioner's share of its ordinary loss for 1977 was $837.

On the 1977 partnership tax return, which was signed by Albert McCardle, withdrawals of property by Paul Fisher and Albert McCardle were reported in the amount of $26,858[5] each. The return did not indicate that the partnership was terminated during 1977, that the partnerhsip was not in business during the year, or that the 1977 return was a final return. Paul Fisher's 1977 Schedule K-1 contained no indication that his interest in the partnership terminated during the year.

A sale to Albert McCardle on January 1, 1977, of an "interest in Desert Oasis Park" was reported on petitioners' income tax return for 1977. The gross sales price was reported as $15,000 and the basis was reported as $26,858. The audit of the partnership records, resulted in a downward adjustment to the basis of property withdrawn by the partners in 1977 in the amount of $2,121.

The above adjustments to the partnership return caused the capital account of Paul Fisher in McCardle and

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[5] On Paul FIsher's Schedule K-1, the withdrawal was reported as $26,859. Due to rounding problems, the basis to the partnership and value of the property at the time of distribution to the partner was reported on page 2 of his K-1 as $26,858.

Fisher to be reflected as follows at the end of the years under consideration:

December 31, 1975, balance:		$ 49,290
1976:	Capital contributions	26,350
	Capital income	21,372
	Capital gains	2,936
	Cash withdrawal	(3,000)
December 31, 1976, balance:		$ 96,948
1977:	Capital contributions	3,100
	Ordinary loss	(837)
	Property withdrawal	(24,737)
December 31, 1977 balance:		$ 74,474

On March 15, 1983, Paul Fisher was indicted in the United States District Court for the Western District of Texas on two counts of willfully attempting to evade and defeat income taxes for 1976 (Count 1) and 1977 (Count 2) in violation of section 7201 and two counts of willfully making false returns for 1976 (Count 3) and 1977 (Count 4) in violation of section 7206(1).

Pursuant to a plea bargain agreement which was entered into by petitioner and his counsel with the United States Attorney and filed in the district court on September 14, 1983 Paul Fisher on October 21, 1983 pleaded guilty to Count 3 of the indictment. (violation of section 7206(1) for 1976) and the other counts of the indictment were dismissed.

Thereafter on March 5, 1984 petitioners executed an agreement on Form 872-A (Special Consent to Extend the Time to Assess Tax) extending the statutory period for the assessment of any income tax due for 1977 but only if section 6501(e) is applicable. Respondent executed the Form 872A on March 8, 1984. The record does not contain a

Form 872T (Notice of Termination of Special Consent to Extend Time to Assess Tax) executed by either party for the purpose of terminating the extension agreed to in the Form 872-A.

OPINION

1. *Fraud*

Both parties recognize that the key issue in this case is whether or not the returns filed by petitioners for 1976 and 1977 are fraudulent within the meaning of section 6653(b). This is true because the resolution of this issue will not only dispose of the question of liability for the addition to tax under section 6653(b) but also the question of whether an assessment for either or both years is barred by the three year statute of limitations provided in section 6501(a). The burden of proof with respect to fraud is upon respondent. Sections 7454(a);Rule 142(b).

Part of respondent's burden is to establish by clear and convincing evidence that there is some underpayment in tax for each year. *Plunkett v. Commissioner,* 465 F.2d 299, 303 (7th Cir. 1972) affg. a Memorandum Opinion of this Court; *Hebrank v. Commissioner,* 81 T.C. 640, 642 (1983). Respondent undertook to carry this part of his burden of proof by use for the most part[6] of the net worth plus cash expenditures method of reconstructing income. The use of this method is proper in this case because petitioner admittedly failed to keep complete books and records during the years at issue. Under such circumstances respondent is authorized by section 446 to

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[6] Part of the deficiency is due to specific adjustments made by respondent's agents to the partnership return of McCardle and Fisher. Petitioners have not objected to the partnership adjustments or to resulting adjustments to Paul Fisher's distributive share of the partnership profits and losses.

compute income by any method, which in his opinion, clearly reflects income. See *Moore v. Commissioner.* 722 F.2d 193, 196 (5th Cir. 1984), affg. a Memorandum Opinion of this Court; *Sutherland v. Commissioner,* 32 T.C. 862 (1959). Furthemore, in such a case respondent has great latitude in adopting a method for reconstructing a taxpayer's income and the method adopted need only be reasonable in the light of all surrounding facts and circumstances. *Giddio v. Commissioner,* 54 T.C. 1530, 1533 (1970); *Schroeder v. Commissioner,* 40 T.C. 30, 33 (1963).

The use of the net worth and cash expenditures method has long been accepted as a proper method of reconstructing income under circumstances similar to those in this case. See *Holland v. United States,* 348 U.S. 121 (1954); *Cefalu v. Commissioner,* 276 F.2d 122 (5th Cir. 1960), affg. a Memorandum Opinion of this Court; *Davis v. Commissioner,* 239 F.2d 187 (7th Cir. 1956), affg. a Memorandum Opinion of this Court; *Lipsitz v. Commissioner,* 21 T.C. 917 (1954), affd. 220 F.2d 871 (4th Cir. 1955).

In addition, in this case petitioners did not challenge the use of the method but only questioned the accuracy of respondent's computations in several respects. We will consider each of the questions raised by petitioners with respect to respondent's computations while keeping in mind that an error in part of the computation will not by itself destroy the validity of the remainder or invalidate the use by respondent of the net worth method. *Marcelo v. Commissioner,* 380 F.2d 494, 497 (5th Cir. 1967), affg. a Memorandum Opinion of this Court; *Cefalu v. Commissioner, supra* at 125; *Harper v. Commissioner,* 54 T.C. 1121, 1129 (1970).

First petitioners argue that the case on hand at December 31, 1975 is understated in respondent's net

worth computation by $7,500 with the result that their income for 1976 is overstated in the computation by an equal amount. This argument is based on petitioners' claim that cashier's check number 8094 was still in petitioner's possession on December 31, 1975. The undisputed evidence on this point is that the cashier's check was purchased in El Paso by Paul Fisher on December 24, 1975 and that the check was thereafter forwarded by Fisher to Bobby Chapman who cashed it in Dallas on January 14, 1976. Both Paul Fisher and Chapman testified, and we have so found, that it was their practice for one of them to forward to the other a cashier's check upon settling up and that such checks were promptly forwarded on demand by the indebted party. This testimony as well as the undisputed dates when the check was purchased and cashed is clear and convincing evidence that the check was not still in the possession of Fisher on December 31, 1975 especially in view of Chapman's testimony that he would frequently hold such checks for extended periods of time after their receipt. The record contains no evidence from which a contrary inference can be drawn except Fisher's vague and uncorroborated testimony that to the best of his memory the check was still in his possession on December 31, 1975. We of course are not bound to accept such testimony at face value even if it is uncontroverted, if as here, it is unreasonable or questionable from the record as a whole. *Quock Ting v. United States,* 140 U.S. 417 (1891); *Fleischer v. Commissioner,* 403 F.2d 403, 406 (2d Cir. 1968), affg. a Memorandum Opinion of this Court; *Archer v. Commissioner,* 227 F.2d 270, 273 (5th Cir. 1955), affg. a Memorandum Opinion of this Court; *Dougherty v. Commissioner,* 60 T.C. 917, 923-933 (1973). We conclude, therefore, that respondent has established that cashier's check number 8094 was not in Fisher's possession on December 31, 1975.

Secondly, petitioners argue that respondent failed to

give them credit for $5,000 in the net worth computation for the collection of a receivable from Lee Chagra in January, 1976. We have found that in respondent's net worth computation, the amount of petitioner's liability to Caesar's Palace was shown as $5,000 at the end of 1975 and zero at the end of 1976. We have also found that the reason the balance at the end of 1976 was zero is that in May of 1976 Lee Chagra satisfied a gambling debt due to Paul Fisher by causing petitioner's debt of $5,000 to Caesar's Palace to be transferred to his (Chagra's) account at Caesar's Palace. Under the circumstances we are satisfied that respodent's computation with respect to this item is correct.

Thirdly, petitioners argue that Paul Fisher received loans from his parents in 1976 of $12,000 and in 1977 of $7,000 for which no allowance was made in respondent's net worth calculation. In an attempt to corroborate Fisher's testimony to this effect, petitioners introduced a letter from his father which stated "Oh yeah, I still have you on my books for the $12,000 in 1976 and $7,000 in 1977. You know it may be a cold winter." Fisher testified that the letter, postmarked December 21, 1978, referred to the loans made to him in 1976 and 1977 an was "Dad's way of acknowledging the debt, and, in a very mild way, of asking * * * about payment of it."

However, at the first meeting between Revenue Agent Rocha and petitioner, Paul Fisher told the agent that he had not received any loans in 1976 or 1977 and that the only loan payable he had outstanding at that time was the one on his house. At their fourth meeting petitioner attempted to explain the discrepancy which the agent had found between deposits made be petitioner and the income reported on the 1977 return as being a loan of $7,000 from his father. At their fifth interview on December 18, 1978, petitioner provided Mr. Rocha with his own analysis of the

bank deposits for 1977 which did not include a deposit identified as a loan from his father. However, on February 5, 1979, petitioner produced the letter postmarked December 21, 1978, which belatedly mentioned albeit in very indefinite terms both a loan in 1976 and one in 1977.

Furthermore, Special Agent Wagner testified that when petitioner's parents failed to produce any evidence tending to corroborate the loans, he performed a detailed analysis of their bank records and was unable to identify any transaction which would tend to corroborate such loans; and at trial, petitioner's parents were both present but were not called by petitioner to corroborate the loans. Here, as noted, petitioner is challenging the accuracy of respondent's computations. In this situation the failure of a party to call such available witnesses who purportedly have knowledge about relevant facts is a sufficient basis for an inference that the testimony or such witnesses would not have been favorable to the party. *Kamborian v. Commissioner,* 56 T.C. 847 (1971), affd. 469 F.2d 219 (1st Cir. 1972); *Pollack v. Commissioner,* 47 T.C. (1966), affd. 392 F.2d 409 (5th Cir. 1968).[7]

Fourthly, petitioners argue that respondent improperly included in the net worth computation a $21,050 debt to Paul Fisher from Albert McCardle at the end of 1977 because the admitted debt was "totally worthless" at that time. The argument is without merit, however, since in a net worth computation assets are included at cost and the alleged inability of McCardle to pay the debt is not relevant. *Schultz v. Commissioner,* 278 F.2d 927 (5th Cir.

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[7] We have considered petitioners' argument on brief that the parents were equally available as witnesses for respondent and his failure to call them gives rise to an inference that their testimony would have been adverse to respondent. In view of the relationship of the parties and the obvious hostility of the parents toward respondent we cannot agree.

1960), revg. and remanding on another issue 30 T.C. 256 (1958); *Cox v. Commissioner,* 54 T.C. 1735, 1741 (1970).[8]

Fifthly, on brief, petitioners argue that Paul Fisher had no capital interest in the McCardle and Fisher partnership on December 31, 1977 and that respondent erroneously included his capital account balance of $74,474 in the net worth computation. This argument is based on the assertion that Fisher sold his entire interest in the partnership to Albert McCardle on January 1, 1977.

The record, however, contains no evidence which tends to directly support the assertion. In fact, the record as a whole clearly and convincingly establishes that petitioner disposed of only part of his partnership interest on January 1, 1977 and that at the end of 1977 he still had a partnership interest with a capital account balance of $74,474. This conclusion is not only supported by the partnership audit conducted by respondent's agent but also by the 1977 partnership return which indicates that the two man partnership was still in business at the end of 1977 and that it was in business throughout the year. Neither the partnership was still in business at the end of 1977 and that it was in business throughout the year. Neither the partnership return nor Paul Fisher's Schedule K-1 contain any indication that his partnership interest terminated during the year.

Petitioners contend that the sale of Fisher's entire partnership interest was reported on their return for 1977. In support of this contention they point to the sale which we have found was reported on the 1977 return of Fisher's interest in Desert Oasis Park on January 1, 1977. Petitioners claim on brief that Desert Oasis Park, Paso View,

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[8] We note that petitioner does not claim and therefore we have not considered whether petitioner is entitled to a bad debt deduction under section 166.

and McCardle and Fisher are all different names for the same partnership entity and that the reported sale of his interest in Desert Oasis Park represented the disposition of his entire interest in the partnership. This claim is at odds, however, with the testimony of Mr. Larkin, who prepared the partnership return and who knew that Sedert Oasis Park was only part of the partnership. It is also at odds with the 1977 partnership return and Fisher's K-1 both of which were prepared by Mr. Larkin, as well as our findings that (1) during 1977 Fisher made capital contributions of $3,100 to McCardle an Fisher and (2) reported $4,510 in ordinary income from the partnership on Schedule E to his 1977 Form 1040. On the other hand, the sale of Desert Oasis Park on January 1, 1977 is clearly supported not only by petitioners' individual return for 1977 but by the fact that the 1976 partnership return of McCardle and Fisher contains transactions from Desert Oasis Park (including depreciation) but no such transactions are included in the 1977 partnership return.

From all of the foregoing we conclude that respondent has established that Fisher did not dispose of his entire interest in the partnership on January 1, 1977 and that as of the end of the year he was still a partner in the partnership with a capital account balance of $74.474 as determined by respondent.

Sixthly, petitioners argue that the net worth computation erroneously reduces a nonexistent debt by Paul Fisher to J. L. Fisher by $7,479 in 1976 and 3,150 in 1977. In support of this argument petitioners claim that the full amount of the purchase price of his father's interest in the Lampasas store, or $21,000 as recited in the deed, was paid by Paul Fisher on the date of sale in 1972. On brief they point to the recital in the deed that the total consideration was $21,000 and Paul Fisher's self-serving statement at trial that the interest in the store was purchased under

"the terms reflected in the deed." However, the argument ignores the fact that no specific terms of payment are recited in the deed and that respondent produced clear and convincing evidence that regular payments were made by Paul Fisher during the years at issue to his father and that such payments had been made since about the year of the purchase.[9] We conclude, therefore, that respondent's computation correctly reflects the payments during 1976 and 1977.

Seventhly, petitioners claim that Paul Fisher disposed of his interest in the partnership, Crystal Park, in 1977 and respondent's net worth computation should be reduced by the $30000 indebtedness to the First National Bank of Lampasas which he incurred in 1974 in order to make his investment in the partnership. Petitioner's argument is unclear but as best we can ascertain he claims the reduction should be made in the form of a loss because he had to repay the $30,000 to the bank. In any event the argument is without merit because from the record as a whole it is clear, and we have so found, that his entire investment in the Crystal Park Limited Partnership was the $30,000 he obtained from the bank in 1974 and that on the returns for 1974 and 1975 he decucted as his share of the partnership losses a total of $29,992.12 ($3,454.12 for 1974 and $26,538.00 for 1977). Consequently any deduction in the years under consideration would be limited to his remaining basis of 88 cents in his partnership interest. We conclude, therefore, that no adjustment to this part of respondent's computation is warrented.

Eightly, petitioners argue that respondent's net worth computation erroneously includes payments made by Paul Fisher on a debt of his daughter, Kelly Fisher. We

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[9] Here again the failure of petitioners to call the father who was available supports an inference that, if called, his testimony would not have been favorable to them. See note 7, *supra*.

have found that Kelly Fisher was primarily respondible for the loan which was used by her to purchase a car. We have also found, however, that Paul Fisher co-signed her note; and the record clearly reflects that the loan repayments during 1976 and 1977 were made by him and thus respondent's treatment of the loan is correct.

In final analysis, petitioners' principal dispute with respect to respondent's net worth computation is that all of the cashier's checks, both those cashed at the Merchant State Bank in Dallas and those cashed elsewhere, totalling $35,700 in 1976 and $48,450, were erroneously included in respondent's net worth computation. Petitioners contend that all of these checks represent the payment of gambling debts by Paul Fisher and that under the facts involved in this case should not be used in such a manner as to reflect unreported income.

Petitioners, however, overlook the fact that even if we assume without so finding that they are correct and that these checks represented the payment of gambling debts, the record would still contain clear and convincing evidence produced by respondent that their income was understated by $63,913.60 in 1976 and $58,478.01 in 1977. This is true because respondent's net worth computation clearly establishes that the source of the cashier's checks was not from reported income or from income which could otherwise be identified by respondent's agents or by petitioners. Consequently, if adopted in toto, petitioners' argument with respect to these checks at best would lead to the conclusion that both gambling income and gambling losses were understated by the same amount. This conclusion is apparent from the fact that with the elimination of the cashier's checks respondent's computation would still reflect an understatement of income of $64,913.50 and $59,478.01 for 1976 and 1977, respectfully, as reflected

below:

	1986	1977
Understatement per resp.	$100,613.50	$107,928.01
Less cashier's checks	(35,700.00)	(48,450.00)
	64,913.50	59,478.01
Less concession by respondent[10]	(1,000.00)	(1,000.00)
Balance	$ 63,913.50	$ 58,478.01

From all of the foregoing we conclude that respondent has clearly and convincingly carried his burden of establishing an underapyment in petitioners' income tax for each of the years 1976 and 1977.

We now turn to the question of whether respondent has carried his burden of proving by clear and convincing evidence that at least some part of the underpayment in tax for each year was due to fraud on the part of Paul Fisher. Section 7454(a); Rule 142(b). The burden is met if respondent has shown by such evidence that Fisher intended to evade the payment of income taxes in each year which he knew to be owing by conduct intended to conceal, mislead or otherwise prevent the collection of such taxes. *Stoltzfus v. United States,* 398 F.2d 1002, 1004 (3d Cir. 1968), cert. denied 393 U.S. 1020 (1969); *Webb v. Commissioner,* 394 F.2d 366 (5th Cir. 1968), affg. a Memorandum Opinion of this Court; *Rowlee v. Commissioner,* 80 T.C. 1111, 1123 (1983).

The presence or absence of fraud is a question of fact to be determined from the entire record. *Gajewski v. Commissioner,* 67 T.C. 181, 199 (1976), affd. without published

[10] On brief respondent conceded that club dues to the extent of $1,000 in each year were deductible by petitioners.

opinion 578 F.2d 1383 (8th Cir. 1978). Fraud is never presumed but must be established by affirmative evidence. *Beaver v. Commissioner,* 55 T.C. 85 (1970). It may, however, be proved by circumstantial evidence because direct proof of the taxpayer's intent is rarely available. The taxpayer's entire course of conduct may be examined in order to determine whether the fraudulent intent is present. *Stone v. Commissioner,* 56 T.C. 213, 223-224 (1971); *Otsuki v. Commissioner,* 53 T.C. 96, 105-106 (1969).

From the record as a whole, we are satisfied that respondent has carried his burden of proving with clear and convincing evidence that the underpayment in income tax for 1976 and 1977 is due to the fraudulent acts of Paul Fisher for the following reasons:

(a) During the years 1976 and 1977, Paul Fisher, a well educated, reasonably intelligent, mature individual with considerable experience in business, obviously knew that income from whatever source derived was taxable and that he was required to keep proper records of such income under the Internal Revenue Code.

(b) He, however, admittedly kept no record of his winnings or his losses in his numerous and daily gambling activities. The failure to keep such records is some evidence of a fraudulent intent. *Bradford v. Commissioner,* 796 F.2d 303 (9th Cir. 1986), affg. a Memorandum Opinion of this Court; *Grosshandler v. Commissioner,* 75 T.C. 1 (1980); *Parsons v. Commissioner,* 43 T.C. 378 (1964).

(c) In his gambling activities he used cash and its equivalent (cashier's checks made payable to fictitious parties) extensively. Such activities have been found to be evidence of fraud. *Bradford v. Commissioner, supra; Gromacki v. Commissioner,* 361 F.2d 727 (7th Cir. 1966), affg. a Memorandum of this Court.

(d) The use of cashier's checks made payable to fictitious payees in his gambling activities obviously made it difficult if not impossible to trace payments or to reconstruct the various transactions in which he was involved. Engaging in such conduct the likely effect of which is to mislead or concel has been held to be evidence of fraud. *Spies v. United States,* 317 U.S. 492, 499 (1943).

(e) During the audit of petitioners' returns Fisher repeatedly made false and misleading statements to respondent's agents. Such conduct is evidence of a fraudulent intent. *Grosshandler v. Commissioner, supra.*

(f) On October 21, 1983 Paul Fisher pleaded guilty to having willfully made a false return for 1976 in violation of section 7206(1). Such a plea is some evidence of fraud with respect to 1976. See *Wright v. Commissioner,* 84 T.C. 636 (1985).

2. *Statute of Limitations*

In view of our conclusion with respect to the fraudulent nature of the 1976 and 1977 returns the respondent's deficiency notice could have been issued at any time under section 6501(c) and, therefore, such notice was timely. *Singleton v. Commissioner,* 606 F.2d 50 (3d Cir. 1979), affg. a Memorandum Opinion of this Court; *Shaw v. Commissioner,* 27 T.C. 561 (1956), affg. 252 F.2d 681 (6th Cir. 1958). We conclude, therefore that the assessment of the deficiencies and additions to tax are not barred by the statute of limitations.

3. *Deficiencies*

Petitioners have proceeded in this case on the assumption that they do not have to prove the correct amount of the deficiencies. In other words, they incorrectly contend that respondent has the burden of proving the cor-

rect amount of the deficiencies due from petitioners from 1976 and 1977. Their error is aptly demonstrated by *Byron v. Commissioner*, 209 F.2d 822, 825 (5th Cir. 1954), affg. a Memorandum Opinion of this Court, cert. denied 348 U.S. 912 (1955), where the Court of Appeals stated:

> While ordinarily a determination of tax liability made by the Commissioner is presumptively correct and the burden rests upon the taxpayer to prove it erroneous, in any proceeding involving the issue of fraud with intent to evade tax, the burden of proof with respect to the issue of fraud is upon the Commissioner. Thus in any case where a deficiency in tax is determined by the Commissioner after the three year period of limitation has expired and the civil fraud penalty is asserted, the burden isupon the Commissioner, in an appropriate proceeding where the validity of an assessment based upon such determination is contested, to established by clear and convincing proof the existence of fraud. *This, however, does not shift the burden of overcoming the presumptive correctness of the Commissioner's determination of deficiency from the taxpayer. When the Commissioner establishes that the returns were fraudulent and were filed with intent to evade tax, he has discharged the burden of proof imposed upon him by Section 1112, supra, and thereby the bar of the three year period of limitation is avoided. Thereafter, if the taxpayer is to escape the deficiency and the imposition of the civil fraud penalty, he must go forward with the proof and show that the determination of deficiency is erroneous.* Since we are of this view, we reject the contention of the taxpayer that the Tax Court erred in holding that "once fraud is established, the statute of limitations does not apply and the petitioner must disprove the deficiencies." [Emphasis supplied; fn. ref. omitted.]

To the same effect see *Harris v. Commissioner,* 174 F.2d 70 (4th Cir. 1949), affg. a Memorandum Opinion of this Court; *Cohen v. Commissioner,* 176 F.2d 394 (10th Cir. 1949), affg. 10 T.C. 201 (1948), 9 T.C. 1206 (1947), and two Memorandum Opinions of this Court; and *Snell Isle, Inc. v. Commissioner,* 90 F.2d 481 (5th Cir. 1937), affg. 33 B.T.A. 1278 (1935), cert. denied 302 U.S. 734 (1937).

As stated hereinbefore respondent had the burden of proving as part of his fraud case against Paul Fisher that there was some underpayment in income tax due from petitioners for each of the years 1976 and 1977. We have found that respondent's net worth computation was more than sufficient to carry that burden. Consequently once the Commissioner had carried his burden of proving that the returns were fraudulent (including proof by the net worth computation that there was some underpayment in each year) the burden shifted to petitioners to go forward with the proof and overcome the statutory presumption that the respondent's determination of the deficiencies is correct. *Bryon v. Commissionner, supra.* This petitioners have failed to do. Consequently, the respondent's determination of the deficiencies is sustained with the exception of the one concession made by respondent on brief.

Decision will be entered under Rule 155.

APPENDIX B

UNITED STATES TAX COURT

PAUL AND MELINDA FISHER,	)	
Petitioner's	)	
v.	)	Docket No. 39308-85
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed April 12, 1988, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That there are deficiencies in income tax due from the petitioners for the taxable years 1976 and 1977 in the amounts of $27,476.55 and $42,493.82, respectfully; and

That there are additions to tax due from petitioner Paul Fisher under I.R.C. § 6653(b) for the taxable years 1976 and 1977 in the amounts of $13,738.28 and $21,246.91, respectfully.

(Signed) Perry Shields

Judge.

Entered: (date illegible)

* * * * *

APPENDIX C

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 89-4381

PAUL AND MELINDA FISHER,
Petitioners-Appellants,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Appeal from the Decision of the United States Tax Court
(TC NO. 39308-85)

(May 22, 1990)

Before BROWN, WILLIAMS, and JONES, Circuit Judges.

EDITH H. JONES, Circuit Judge:[1]

Taxpayers Paul and Melinda Fisher seek review of a Tax Court judgment upholding tax deficiencies and fraud penalties assessed by the Commissioner of Internal Revenue (the "Commissioner"). Finding the Fishers' con-

[1] Local Rule 47.5 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession." Pursuant to that Rule, the court has determined that this opinion should not be published.

tentions on appeal unpersuasive, we affirm the judgment of the Tax Court.

I.

BACKGROUND

The Fishers lived in El Paso, Texas during 1976 and 1977. They filed timely joint income tax returns for each of those years. Their returns reflected adjusted gross incomes of $12,261 in 1976 and $11,925 in 1977. After conducting an audit and reconstructing the Fishers' income through the net worth accounting method, the Commissioner sent the Fishers a notice of deficiency for 1976 and 1977 on October 10, 1985.[2]

Paul Fisher graduated in 1957 from the University of Texas with a degree in business administration. During 1976 andd 1977, Mr. Fisher earned income through several investments. The Tax Court also found that during those years, and for several years before, Fisher was an inveterate gambler. He bet on golf, poker, gin rummy, and football games, as well as at the casinos in Las Vegas and Reno. An accomplished golfer, Fisher joined several counrty clubs after he concluded that he could make more money gambling there than the membership dues would cost him. He played golf and poker for money at these clubs almost every day during the years in question. All of these wages were paid in cash, and no records were kept of Fisher's winnings or losses.

Fisher also bet on football games by placing wagers

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[2] Melinda Fisher is a party to this action solely by virtue of having signed a joint return with Paul Fisher. The fraud penalty under I.R.C. § 6653(b) was not determined against Melinda Fisher in the statutory notice of deficiency.

over the telephone with a Dallas, Texas, bookie named Bobby Joe Chapman. Chapman and Fisher did not "settle up" after every bet. Rather, Chapman kept temporary records of Fisher's winnings and losses, and when one of them wanted to settle up, payment was promptly made, typically in the form of cashier's checks made out to fictitious payees. Chapman would then routinely hold these checks for some period of time, sometimes sending the same checks back to Fisher if Fisher later showed a net gain. Because bookmaking is illegal in Texas, Chapman destroyed his records as soon as payment was made. Fisher kept no records of his dealings with Chapman.

Despite the volume of his wagering, Fisher did not report any gambling income on his 1976 return. On his 1977 return, Fisher reported $15,000 of gambling winnings as "other income".

The Commissioner began investigating the Fishers in 1978. Paul Fisher had several interviews with Revenue Agent Paul Rocha in which Fisher frequently gave contradictory answers to questions about his finances. After reconstructing the Fishers' income for 1976 and 1977 through the net worth accounting method, the Commissione's agents determined that the Fishers had understated their adjusted gross income by $113.791 in 1976 and by $104,703 in 1977.

In 1983 Paul Fisher was indicted on two counts of willfully attempting to evade and defeat income taxes and on two counts of willfully making false returns. Pursuant to a plea bargain, Fisher pled guilty to willfully making a false return for 1976, and the other charges were dismissed. The net worth calculations were then adopted in the notice of deficiency sent to the Fishers in 1985. The Fishers fruitlessly sought review in the Tax Court, which affirmed the Commissioner's assessments, and they now appeal.

II.

ANALYSIS

A. Burden of Proof

The Fishers contend that the Tax Court erroneously placed the burden of proof on them to disprove the Commissioner's notice of deficiency. We disagree. This court has previously described the proper allocation of the burden of proof in cases such as this one. In **Bryan v. Commissioner**, 209 F.2d 822 (5th Cir. 1954, *cert. denied*, 348 U.S. 912 (1955), the Commissioner sought to show the existence of fraud to avoid the Internal Revenue Code's three year statute of limitations and to allow the imposition of fraud penalties. The court noted that "ordinarily a determination of tax liability made by the Commissioner is presumptively correct and the burden rests upon the taxpayer to prove it erroneous. . . . "**Bryan**, 209 F.2d at 825. However, in a proceeding initiated after the three year period of limitation has expired and in which a civil fraud penalty is asserted, the Commissioner bears the burden of proving the esistence of fraud. *Id.* Once the Commissioner has proven fraud, the burden remains on the taxpayer to disprove the presumptive correctness of the Commissioner's determination of deficiency if he is to escape liability for the deficiency. *Id.; see also* **Jackson v. Commissioner**, 380 F.2d 661, 664 (6th Cir.), *cert. denied*, 389 U.S. 1015 (1967) (once fraud is established, the burden is on the taxpayer to disprove the Commissioner's redetermination of taxes).

In this case the Tax Court correctly allocated the burden of proof. The Commissioner sought to show fraud on the Fishers' part to avoid the three year statute of limitations, I.R.C. § 6501, and to impose penalties for fraud, I.R.C. § 6653(b). The Tax Court correctly placed the burden on the Commissioner to prove the existence of

fraud by clear and convincing evidence. Part of the Commissioner's burden of proving fraud is to prove some underpayment in tax for each year. *See* **Plunkett v. Commissioner,** 465 F.2d 299, 303 (7th Cir. 1972). However, once the Commissioner had proven fraud, the burden was then on the Fishers to disprove the correctness of the Commissioner's determination of deficiency.

B. The New Worth Computation

The Commissioner's recomputation of the Fishers' income through net worth accounting appears as follows:

NET WORTH COMPUTATION

ASSETS	12-31-75	12-31-76	12-31-77
Cash on Hand	$ 1,000.00	$ 4,000.00	$ 10,000.00
Cash in Banks	($ 1,392.63)	$ 4,086.64	$ 10,260.47
Receivables	$ 11,200.00	$ 20,550.00	$ 23,150.00
Prepaid Interest	$ 532.77	$ 326.49	$ -0-
Automobiles			$ 7,415.80
Escrow Account	$ 323.00	$ 122.25	$ -0-
Residence	$ 32,000.00	$ 32,000.00	$ 40,916.00
Store Building	$ 43,533.00	$ 43,533.00	$ 43,533.00
Capital Account	$ 49,290.00	$ 96,948.00	$ 74,474.00
TOTAL ASSETS	$136,486.14	$201,566.38	$209,749.27

LIABILITIES	12-31-75	12-31-76	12-31-77
Bank Loans	$ 53,009.53	$ 48,907.08	$ 14,870.36
Casino Loans	$ 5,500.00	$ 10,000.00	$ 10,000.00
J. L. Fisher	$ 22,000.00	$ 14,521.00	$ 11,371.00
Martin Bauman	$ 7,750.00	$ 4,750.00	$ 1,750.00
Reserve for Depreciation	$ 1,658.00	$ 3,289.00	$ 4,920.00
TOTAL LIABILITIES	$ 89,917.53	$ 81,467.08	$ 42,911.36
NET WORTH	**$ 46,568.61**	**$120,099.30**	**$166,837.91**
Less Prior Year's Net Worth		$ 46,568.61	$120,099.30
Increase in Net Worth		$ 73,530.69	$ 46,738.61
Personal Living Expenses		$ 19,351.98	$ 21,496.40
Other Expenditures (Cashier's checks)		$ 35,700.00	$ 48,500.00
Payments from Gilbert Felts		($ 550.00)	
Insurance Proceeds		($ 592.97)	
§1202 Deduction		($ 1,468.00)	
Corrected AGI		$125,971.70	$116,685.01
Reported AGI		$ 12,261.00	$ 11,925.00
Omitted Gross Income		$113,710.70	$104,760.01

The Fishers challenge several items in the Commission's net worth computation, contending primarily that with regard to each item the Commissioner has failed to carry his burden of proving an understatement of income. We address each of the Fishers' contentions in turn. We review the Tax Court's findings of fact under the clearly erroneous standard. **Laney v. Commissioner**, 674 F.2d 342, 345 (5th Cir. 1982).

1. *Beginning Cash on Hand*

The Fishers first contend that the amount of cash on hand at the beginning of 1976 is understated by $7,500.00. That $7,500.00 represents a cashier's check (No. 8094) purchased by Paul Fisher on December 24, 1975 and cashed by Bobby Joe Chapman in Dallas on January 14, 1976.[3] The Fishers argue that the $7,500 should have been added to the beginning cash on hand because the check was still in Paul Fisher's possession on January 1, 1976.

The Tax Court found that the uncontested evidence regarding the dates when the check was purchased and cashed was clear and convincing evidence that Fisher did not have the check on January 1, 1976. This was especially so in light of the evidence of the course of prior dealings between Fisher and Chapman. The evidence established that *Chapman* would frequently hold the checks for some time before cashing them. It was also established that when payment was requested by one of the men, it was *promptly* made. The only support for the Fishers' contention is Paul Fisher's testimony, described by the Tax Court as "vague and uncorroborated", that to the best of his knowledge he still had the check on January 1, 1976. The Tax Court was not required to accept such dubious testimony at face value. *See* **Archer v. Commissioner,** 227 F.2d 270, 273 (5th Cir. 1955). Accordingly, the Tax Court's finding that Fisher did not have the check at the beginning of 1976 is not clearly erroneous.

2. *Purchase of Lampasas Store*

In 1972, Paul Fisher purchased his father's 50%

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[3] Check No. 8094 is payable to "Robert Miller"; however, both parties agreed, and the Tax Court found, that the check was actually cashed by Bobby Joe Chapman. In addition to the "Robert Miller" endorsement, the back of Check No. 8094 also bears the initials "B.J.C.".

share of a tire store in Lampasas, Texas, for $21,000.00 The Commissioner determined that the sale was made on credit and his net worth computation reduced the debt owed by Fisher to his father by $7,479.00 for payments made in 1976 and by $3,150.00 for payments in 1977. The Fishers contend that the entire purchase price was paid at the time of the sale, so there was no debt to reduce. However, as the Tax Court noted, the Commissioner produced clear evidence of regular payments on the loan. In contrast, the Fishers rely only on the deed, which contains no specific terms of payment. Furthemore, the Tax Court inferred from the Fishers' failure to cal Paul Fisher's father as a witness that his testimony would have been unfavorable to the Fihsers.[4] The Tax Court did not err by finding that the Commissioner established the existence and reduction of this debt.

3. Loans

The Fishers next contend that Paul Fisher received loans from his parents of $12,000.00 in 1976 and of $7,000.00 in 1977 for which no allowance was made in the net worth calculations. In support of their claim the Fishers rely on an ambiguous letter from Paul Fisher's father which states "Oh yeah, I still have you on my books for the $12,000.00 in 1976 and $7,000.00 in 1977. You know it may be a cold winter." However, at his first interview with Agent Rocha, Paul Fisher specifically told the agent that he had not received any loans during 1976 or 1977. It

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[4] Fisher contends that by drawing this inference the Tax Court impermissibly placed the burden of proof on him. However, in **Steiner v. Commissioner**, 350 F.2d 217, 222-223 (5th Cir. 1965), this court specifically ruled that once the Commissioner has made out a prima facie fraud case, the Tax Court may draw adverse inferences from the taxpayer's failure to call witnesses who would otherwise be expected to be favorable to him, without shifting the burden of proof to the taxpayer.

was not until his fourth meeting with Rocha that Fisher offered parental loans as an explanation for the discrepancies between his reported income and his bank deposits. Furthermore, Fisher's own analysis of his bank deposits for 1976 and 1977 did not include any deposits identified as loans from his parents.

The Commissioner's agents followed up on the Fishers' lead by interviewing Paul Fisher's parents, who were unable to produe any evidence corroborating the loans. Agents then performed a detailed analysis of the parents' bank records and were unable to identify any transactions which would correspond with the alleged loans. Though both of Paul Fisher's parents were present at trial, the Fishers failed to call either as a witness. here again, the Tax Court inferred from this failure that the parents' testimony would not have been favorable to the Fishers. The Tax Court's finding that these loans were not made is not clearly erroneous.

4. McCardle Receivable

The Commissioner's net worth computation includes a $21.050 receivable owed to Paul Fisher by his busines partner Albert McCardle at the end of 1977.[5] The Fishers contend that this receivable was worthless because McCardle was insolvent at the end of 1977. The then argue that the receivable should have been included in the computation at its actual value rather than at their basis. We disagree.

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[5] The Fishers' counsel argued for the first time at oral argument that the Commissioner failed to prove the existence of the McCardle debt. This contention is frivolous, since the Fishers stipulated to the amount of the debt before trial.

The Fishers' argument is inconsistent with the operation of the net worth accounting method. Despite its name, the net worth method is used to determine income, not "net worth". Assets are theefore included in a net worth calculation at cost or basis rather than value, *see* **Schultz v. Commissioner,** 278 F.2d 927, 932 (5th Cir. 1960), and diminution in the value of an asset (such as a receivable) is reflected under the net worth accounting method only if the diminution represents a deductible loss. *Id.* "Economic" losses are not reflected in the net worth accounting computatio. *Id.* Since the Fishers have not contended that the McCardle receivable was deductable as a bad debt, they have suffered only an "economic" loss, and the Tax Court correctly determined that the receivable should be included in the Commissioner's computation at cost.[6]

5. Crystal Park Partnership

In 1974 Paul Fisher borrowed $30,000 from the First Nathional Bank of Lampasas which he invested in a real estate limited partnership known as Crystal Park. This $30,000 was the Fishers' total investment in the partnership. On their 1974 and 1975 returns, the Fishers deducted losses from Crystal Park of $3,454.12 and $26,538.00, respectfully. This left the Fishers with a basis of $7.88 in

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[6] The Fishers mistakenly rely on **Schultz,** *supra,* to support their argument that the McCardle receivable should be included in the computation at its true value. In **Schultz,** the taxpayer argued that the Commissioner should have deducted a certain receivable from the net worth calculations after the person who owed the receivable became insolvent. After rejecting the taxpayer's argument that his "economic" loss should be reflected in the net worth computation, the court did remand for a determination of the true value of the receivable. **Schultz,** 278 F.2d at 933. However, in **Schultz,** unlike this case, the taxpayer contended that the receivable had become a deductible bad debt in a relevant tax year. Therefore the actual value of the receivable was relevant in that case.

their partnership interest. Their returns for 1976 and 1977 reflect no income or loss from the partnership. Paul Fisher made payments on the loan of $4,000 in 1976 and $20,895.23 in 1977. These payments were reflected in the net worth computation as reductions in bank loans. However, the partnership interest itself is not reflected in the Commissioner's computations. The Fishers now contend that the Tax Court erred by allowing the inclusion of the Crystal Park debt in the computation without requiring that the corresponding asset (their partnership interest) be included as well. We disagree.

There is not absolute requirement that an asset corresponding to a liability be included in the net worth computation. The Fishers rely on **Scanlon v. United States**, 223 F.2d 382 (1st Cir. 1955), to support their argument. However, **Scanlon** establishes the oppsoite rule. In **Scanlon** the First Circuit held that where an asset is purchased with borrowed funds, the asset may not be included in a net worth computation unless the corresponding debt is also included. *Id.*, at 389. Otherwise, a taxpayer's net worth would be overstated. *See. Id.* In this case there is no such danger. In fact, including a debt in the net worth computation without adding in an asset purchased with the borrowed funds benefits the taxpayer by reducing his calculated net worth. The Tax Court did not err in this regard.[7]

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[7] At oral argument, the Fishers' counsel argued for the first time that the Commissioner failed to prove that the Fishers were not entitled to further loss deductions for the Crystal Park Partnership. However, even if the Commissioner had such a burden, the Fishers had only a $7.88 basis in their partnership share at the beginning of 1976. Therefore they could have been entitled, at most, only to a $7.88 deduction. *See* I.R.C. § 704(d). Even with such a deduction, the Commissioner would clearly have proven a significant understatement of income for both 1976 and 1977. Once fraud was proven, the burden would then of course, be on the Fishers to establish their entitlement to any loss deductions from the partnership. **C.A. White Trucking Co. v. Commissioner**, 601 F.2d 867 (5th Cir. 1979). They failed to do so.

6. Automobile

In 1975 Paul Fisher co-signed a note to allow his daughter to purchase a 1975 Toyota. Fisher then made all the payments on the car during 1976 and 1977. These payments were reflected on the net worth computation. The Fishers contend that the Tax Court erred by not requiring that the computation also include the value of the car. For the reasons states above this argument is meritless.

7. Gambling Losses?

The Commissioner's net worth computation includes as "other expenditures" several cashier's checks purchased by Paul Fisher in 1976 and 1977. These checks total $35,700 for 1976 and $48,450 for 1977. The Fishers contend that all of these checks represent deductible gambling losses rather than non-deductable expenses.[8]

Even if we assume that the Commissioner has not carried his burden of proving that the cashier's checks do not represent deductible gambling expenses, he has proven a sizable understatement of income for each year. For 1976 the Commissioner calculated an understatement of $113,710.70. If the Fishers' contention is correct, however, and the cashier's checks are removed for the expense *and* deducted as gambling losses, the Commissioner has still proven an understatement of the amount of $42,310.70 for

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[8] The Fishers also argue that the commissioner failed to follow up on the gambling debts lead which they supplied. *See* **Holland v. United States**, 348 U.S. 121, 135-36 (1954). This contention is meritless. Agent Schampers conducted an investigation, including a trip to Dallas where he interviewed Merchant State Bank personnel regarding the checks. In addition, Bobby Joe Chapman was asked about these checks during his testimony at trial. Unfortunately, the Commissioner's investigation succeeded only in confirming that one check was cashed by Bobby Joe Chapman (No. 8094), but the Commissioner did not fail to investigate the lead.

1976. For 1977 the Commissioner calculated an understatement of $104,760.01. Removing and deducting the cashier's checks, the Commissioner has, even under the Fishers' scenario, proven an understatement of $7,860.01 for 1977.

Because, as will be seen, the Commissioner carried his burden of proving fraud, the burden then shifted to the Fishers to overcome the presumptive correctness of the notice of deficiency by proving that the checks did in fact represent gambling losses. The only evidence offered by the Fishers was Paul Fisher's testimony. The Fishers presented no records, no receipts, and no witnesses who could support their position. While Bobby Joe Chapman testified, he was unable to remember having cashed any of the checks. under these circumstances we cannot find that the Tax Court erred by determining that the Fishers failed to carry their burden of proof.

C. Proof of Fraud

The Tax Court found that the Commissioner proved fraud by clear and convincing evidence. Accordingly, the court ruled that the three-year stattute of limitations was inapplicable and that the Commissioner was entitled to impose a penalty for fraud. Since the Tax Court's finding of fraud is not clearly erroneous, we do not disturb it. **Patton v. Commissioner,** 799 F.2d 166, 171 (5th Cir. 1986).

We have already concluded in the previous section of this opinion that the Commissioner satisfied the first part of his burden of proof on the fraud issue by proving the existence of an underpayment of tax. *See* **Plumkett v. Commissioner,** 465 F.2d 299, 303 (7th Cir. 1972). We therefore turn to the issue of fraudulent intent.

The Commissioner must prove fraud by clear and convincing evidence, but the fraud need not be shown by direct evidence. **Patton v. Commissioner**, 799 F.2d 166, 171 (5th Cir. 1986). Courts frequently find fraudulent intent from the existence of indicia or badges of fraud. *E.g.*, **Patton**, 799 F.2d at 171. Several indicia of fraud are present in this case. First, the fact that Fisher's income was from illegal activities is evidence of his tax evasive motive. *Id.* Second, Fisher's failure to keep records of his extensive gambling activities is also evidence of his evasive motive. *See* **Bradford v. Commissioner**, 796 F.2d 303 (9th Cir. 1986). This factor was aggravated by the fact that Paul Fisher had a degree in business administration and should have understood the importance of keeping records for tax purposes. Third, Fisher used cash and its equivalent (cashier's checks made payable to fictitious payees) extensively in his gambling activities to make his transactions hard to trace. *See Id.* In addition, Fisher repeatedly made false and inconsistent representations to revenue agents during the investigation, and he pled guilty to willfully filing a false return for 1976. The Tax Court's finding of fraud is not clearly erroneous.[9]

III.

CONCLUSION

We concluded that the Commissioner satisfied his burden of proof of a fraudulent underpayment of tax. Accordingly, the Tax Court correctly ruled that the three

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[9] The Fishers argue in their brief that in order to prove fraud the Commissioner must prove a "consistent pattern of underreporting substantial amounts of income." There is no such requirement. Rather, a consistent pattern of underreporting substantial amounts of income is merely one of the indicia of fraud on which the Commissioner may rely. *See* **Patton v. Commissioner**, 799 F.2d 166, 171 (5th Cir. 1986).

year statute of limitations was inapplicable and that the Commissioner was entitled to impose a penalty for fraud. The burden was then on the Fishers to overcome the presumptive correctness of the Commissioner's computation of the amount of the deficiency. The Tax Court was not clearly erroneous in holding that the Fishers failed to satisfy this burden. Therefore, the judgment of the Tax Court is **AFFIRMED.**

APPENDIX D

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 89-4381

FILED JUN 14 1990

PAUL FISHER and
MELINDA FISHER,
Petitioners-Appellants,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Appeal from the Decision of the United States Tax Court

ON PETITION FOR REHEARING
(June 14, 1990)

Before BROWN, WILLIAMS, and JONES, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby **DENIED.**

ENTERED FOR THE COURT:
6/12/90

/s/ Edith H. Jones
United States Circuit Judge

Supreme Court, U.S.
FILED
OCT 26
CLERK

No. 90-379

In the Supreme Court of the United States

OCTOBER TERM, 1990

PAUL FISHER, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the Commissioner, in a civil tax case employing the net worth method for determining income, may prove fraud by evidence other than a consistent pattern of understating substantial amounts of income.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A33-A47) is unreported, but the decision is noted at 904 F.2d 703 (Table). The opinion and decision of the Tax Court (Pet. App. A1-A32) are reported at 57 T.C.M. (P-H) ¶ 88,151.

JURISDICTION

The judgment of the court of appeals was entered on May 22, 1990. A petition for rehearing was denied on June 14, 1990. Pet. App. A48. The petition for a writ of certiorari was filed on August 27, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioners, who are husband and wife, filed joint federal income tax returns for 1976 and 1977 reporting adjusted gross incomes of $12,261 and $11,925, respectively. Following an audit, the Commissioner employed the net worth method to determine petitioners' income for those years and issued notices of deficiency asserting civil penalties for fraud.[1] Pet. App. A34. The Tax Court sustained the Commissioner's determinations, and the court of appeals affirmed.

1. Petitioner, who holds a degree in business administration from the University of Texas, was an inveterate gambler. He gambled on golf, poker and football, as well as at casinos in Las Vegas. Petitioner joined several golf clubs after concluding that his income from gambling at those clubs would exceed the cost of membership. Most of petitioner's wagers were made in cash, and he kept no record of his winnings or losses. Pet. App. A34.

Petitioner placed bets with a bookie named Bobby Joe Chapman. Petitioner and Chapman did not settle up after each wager. Instead, they kept a running total of winnings and losses. From time to time, one would call the other to request payment. Petitioner paid Chapman by purchasing cashier's checks made out to fictitious persons and sending them to Chapman. Chapman held these checks for a time. If petitioner won subsequent wagers, Chapman returned the checks; if not, he sent the checks to third parties to be cashed. Because bookmaking is illegal in Texas, Chapman destroyed his records as

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[1] The addition to tax for fraud under 26 U.S.C. 6653(b) was asserted only against Paul Fisher. Consequently, the references to "petitioner" in this brief are to Mr. Fisher.

soon as the accounts were settled. Petitioner kept no record of the bets he made with Chapman. Pet. App. A4-A5, A35.

Despite his extensive gambling activities, petitioner reported no gambling income on his 1976 tax return. On his 1977 return, he reported $15,000 of gambling winnings as "other income." Pet. App. A35.

The Commissioner began an investigation of petitioner in 1978. During several interviews with Revenue Agent Paul Rocha, petitioner gave contradictory answers to questions about his finances. Pet. App. A35, A46. For example, petitioner stated that he had received no loans during the years in question, and also that he had received substantial loans from his father. *Id.* at A40-A41. Because petitioners had failed to keep adequate financial records, the Commissioner employed the net worth method to reconstruct their income.[2] The Commissioner determined that petitioners had understated their gross income by $113,791 in 1976 and $104,703 in 1977. *Id.* at A35.

Petitioner was indicted in March 1983 on two counts of willfully attempting to evade and defeat income taxes for 1976 and 1977, and two counts of willfully making false returns for 1976 and 1977. In addition, the Commissioner issued notices of de-

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[2] In applying the net worth method, the Commissioner establishes the taxpayer's net worth at the beginning of the period in question, and then calculates the taxpayer's change in net worth during the period. The taxpayer's income is the sum of his non-deductible expenditures and the change in his net worth. If this sum exceeds the taxable income reported to the government, the difference represents unreported taxable income. See *Holland* v. *United States*, 348 U.S. 121, 125 (1954).

ficiency to petitioners for the 1976 and 1977 tax years that asserted civil penalties for fraud. Pursuant to a plea bargain, petitioner pleaded guilty to willfully making a false return for 1976 and the government dismissed the other criminal charges. Pet. App. A35. Petitioners filed a petition in the Tax Court contesting the Commissioner's determinations and the civil fraud penalties for both years.

2. The Tax Court upheld the determinations and civil penalties. Pet. App. A1-A31. The court concluded that the Commissioner had proved by clear and convincing evidence that there was an underpayment of tax for each year. The court considered and rejected petitioners' various objections to the Commissioner's net worth analysis. *Id.* at A18-A27. In addition, the court held that the Commissioner had proved by clear and convincing evidence that at least part of the underpayment was due to fraud. The court noted that the existence of fraud is determined by examining the entire record. Here, the court found several indicia of fraud, including petitioner's failure to keep records of his gambling activities, his use of cash and cashier's checks payable to fictitious persons, his false and misleading statements to IRS agents, and his plea of guilty to willfully filing a false return for 1976. Because the Commissioner had proved fraud, the court held that the three-year statute of limitations of 26 U.S.C. 6501(a) did not bar the collection of back taxes and penalties. Pet. App. A27-A29.

3. The court of appeals affirmed. Pet. App. A33-A47. The court rejected petitioners' argument that the Tax Court had incorrectly shifted the burden of proof, noting that once the Commissioner meets his burden of proving fraud by clear and convincing evidence, the burden shifts to the taxpayer to prove the

Commissioner's income determinations incorrect. *Id.* at A36-A37. The court also rejected petitioners' objections to the Commissioner's net worth computations. *Id.* at A37-A44. The court considered petitioners' contention that cashier's checks in the amount of $35,700 for 1976 and $48,450 for 1977 represented deductible gambling losses rather than non-deductible living expenses. Even if the cashier's checks are assumed to represent deductible gambling losses, the court observed, the Commissioner proved understatements of $42,310 for 1976 and $7,860 for 1977. Moreover, petitioners failed to present any records, receipts, or witnesses (other than petitioner) to support the contention that the checks represented deductible gambling losses. *Id.* at A44-A45.

The court of appeals upheld the Tax Court's finding of fraudulent intent, noting that several indicia of fraud were present. Petitioner's income was from illegal activities, he failed to keep adequate records despite his knowledge of business practices, he made his transactions difficult to trace by dealing in cash and cashier's checks payable to fictitious third parties, and he made false and inconsistent statements to the IRS agents investigating his activities. Pet. App. A46. In a footnote to its opinion, the court of appeals rejected petitioners' argument that "in order to prove fraud the Commissioner must prove a 'consistent pattern of underreporting substantial amounts of income.' " *Id.* at A46 n.9. The court said that such a pattern is "merely one of the indicia of fraud on which the Commissioner may rely." *Ibid.*

ARGUMENT

Petitioners contend (Pet. 3-6) that the Commissioner, in order to prove fraud in a net worth case, must show a consistent pattern of underreporting substantial amounts of income. In this case, the Commissioner proved that petitioners substantially underreported their income for two consecutive years. And in any event, as the court of appeals correctly observed (Pet. App. A46 n.9), the Commissioner need not show a pattern of underreporting to prove fraud. This Court has recognized that fraud may be shown by "*any* conduct, the likely effect of which would be to mislead or conceal." *Spies* v. *United States*, 317 U.S. 492, 499 (1943) (emphasis added). Accordingly, there is no basis for further review.

1. In order to prove fraud in a net worth case, the Commissioner must show that a not insubstantial amount of income was unreported, and that at least part of the underreporting was due to fraud. See, *e.g.*, *United States* v. *Holovachka*, 314 F.2d 345, 357 (7th Cir.), cert. denied, 374 U.S. 809 (1963). The requirement that the amount of the understatement be not insubstantial allows for the inherent imprecision of the net worth method of proof. See generally *Holland* v. *United States*, 348 U.S. 121, 125-129 (1954). Here, both courts below considered petitioners' objections to the Commissioner's net worth calculations and concluded that the Commissioner had proved, by clear and convincing evidence, a substantial amount of unreported income for both 1976 and 1977. There is no reason for this Court to revisit those fact-bound determinations.[3]

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[3] Petitioner's contention (Pet. 5) that $7,860 of unreported income in 1977 is not "substantial" is untenable. Petitioners

Once the Commissioner demonstrates a not insubstantial understatement of income, he may prove fraud by surveying the taxpayer's entire course of conduct and drawing reasonable inferences from that conduct. See *Korecky* v. *Commissioner*, 781 F.2d 1566, 1568 (11th Cir. 1986). To be sure, a consistent pattern of underreporting substantial amounts of income is convincing evidence of fraudulent intent. See, *e.g.*, *Schwarzkopf* v. *Commissioner*, 246 F.2d 731, 734 (3d Cir. 1957); *Gatling* v. *Commissioner*, 286 F.2d 139, 145 (4th Cir. 1961). But that hardly leads to the conclusion that it is impossible to prove fraud in the absence of such a pattern. Other factors, such as the use of cash or cashier's checks that are difficult to trace, *United States* v. *Holovachka*, 314 F.2d at 358; *Feichtmeir* v. *United States*, 389 F.2d 498, 503-504 (9th Cir. 1968); failure to keep business records despite the knowledge that one should do so, *United States* v. *Allen*, 522 F.2d 1229, 1235 (6th Cir. 1975), cert. denied, 423 U.S. 1072 (1976); *Korecky* v. *Commissioner*, 781 F.2d at 1568; and making inconsistent, false, or misleading statements to IRS agents, *United States* v. *Slutsky*, 487 F.2d 832, 844 (2d Cir. 1973), cert. denied, 416 U.S. 937 (1974) (bank deposit case); *Feichtmeir* v. *United States*, 389 F.2d at 503-504—all of which were present here—also are persuasive indicia of fraud.

Petitioners correctly cite *Holland* v. *United States*, *supra*, for the proposition that fraud may be found from "a consistent pattern of underreporting large amounts of income." 348 U.S. at 139. But nothing in

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reported income of only $11,925 for 1977; by omitting at least $7,860, petitioners understated their actual income by at least 40%.

Holland suggests that such a pattern is a prerequisite to a finding of fraud in a net worth case. On the contrary, *Holland* cited as support for the quoted statement the statement in *Spies* v. *United States* that fraud may be inferred from "any conduct, the likely effect of which would be to mislead or conceal." 348 U.S. at 139 (citing 317 U.S. at 499-500). In addition, *Holland* stated that "[w]hen there are no books and records, willfulness may be inferred * * * from that fact coupled with proof of an understatement of income." 348 U.S. at 128.

Finally, petitioners assert (Pet. 5) that fraud cannot be proved by the net worth method where there is evidence of only one year's understatement of income. As noted above (note 3, *supra*), this contention does not fit the facts of this case, because the Commissioner that proved petitioners substantially understated their income for both 1976 and 1977. In any event, petitioners' contention is incorrect. The Commissioner is not required to wait until a taxpayer has fraudulently underreported his income for several years to assess a fraud penalty. None of the cases cited by petitioners supports such a bizarre rule.[4]

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[4] In *Watts* v. *United States*, 212 F.2d 275 (10th Cir. 1954), only a single tax year was at issue. None of the other cases cited by petitioners (Pet. 4) holds that a multi-year pattern of underreporting is necessary to prove fraud in a net worth case. See *United States* v. *Eley*, 314 F.2d 127, 132 (7th Cir. 1963) (willfulness may be inferred from conduct); *United States* v. *Skalicky*, 615 F.2d 1117, 1120 (5th Cir. 1980), cert. denied, 449 U.S. 832 (1980) (pattern of underreporting, coupled with other evidence, permits an inference of willfulness); *Schwarzkopf* v. *Commissioner*, 246 F.2d 731, 734 (3d Cir. 1957) (consistent pattern, standing alone, is sufficient evidence of fraudulent intent); *Gatling* v. *Commissioner*, 286 F.2d 139, 145 (4th Cir. 1961) (pattern of underreporting may

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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be convincing evidence of fraud; pattern is more convincing when supported by other indicia of fraud); *Epstein* v. *United States*, 246 F.2d 563, 566 (6th Cir. 1957) (consistent pattern is evidence of willful intent), cert. denied, 355 U.S. 868 (1957); *Shaw* v. *Commissioner*, 252 F.2d 681, 683 (6th Cir. 1958) (consistent pattern is persuasive evidence of fraud); *United States* v. *Larson*, 612 F.2d 1301, 1305 (8th Cir. 1980), cert. denied, 446 U.S. 936 (1980) (consistent pattern may be used to establish inference of willfulness). In *United States* v. *Burdick*, 221 F.2d 932 (3d Cir. 1955), cert. denied, 350 U.S. 831 (1955), the court sustained the conviction without resort to the net worth method of proof. 221 F.2d at 933.

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